

Documento de Trabajo

Working Paper

**Latin American Integration and Mercosur
in a World of Multiple Options that are Not
Mutually Exclusive**

Félix Peña

9/10/2007

Working Paper 44/2007

Latin American Integration and Mercosur in a World of Multiple Options that are Not Mutually Exclusive*

*Félix Peña***

Latin American Integration in a World and Region with New Realities

The three most relevant features of current developments in the strategy of Latin American integration are the multiplicity of the various countries' fields of action at both the global and regional levels; the crises and attempts at renewal at institutional bodies, especially Mercosur and the Community of Andean Nations (CAN in Spanish); and a heavy accent on the political and at times even ideological dimension.

To some extent these issues reflect the impact of the dynamics of change that have emerged in recent years on the international scene, with the growing power of new players (China and other emerging economies), new and sensitive issues (energy, bio-fuels, climate change and others) and also new factors on the international and even domestic security agendas.

These changes have left all countries –or at least those willing to take advantage of the new reality, including those of Latin America– open to multiple options that are not mutually exclusive, especially with regard to foreign trade, international investment and the sources of technical progress. In this framework, the old classifications of North-South and South-South in international economic relations show clear signs of being outdated, both in their validity for diagnosis and for action on the global scene by each country and its companies.

The aforementioned features also stem from an international economic context that has been favourable –at least so far– for most Latin American countries. They are also the result of the region's being somewhat removed from the main issues that dominate the agendas –especially economic and security– of the major powers that traditionally wield influence in Latin America, in particular the US and the EU, and for this reason the region also misses out on these countries' political energies.

To a certain extent it can be argued that today the fate of each country in the region is in its own hands. In other words, it depends on the quality of its strategies, policy and organisation, both domestic and external. In particular, China's interest in the region has helped develop a spirit of international economic competition in some countries. They are using the phenomenon of globalisation to their favour by learning to harness its effects and take advantage of the opportunities it provides.

This explains the perception of a certain return to obsolete ideas suggested by recent approaches and rhetoric that are reminiscent of the waging of crusades against the external sources of problems afflicting each Latin American country. And it can also explain the growing interest in China's break with its ideological past, following the radical shift that Deng Xiao Ping imposed on the mobilisation of social energy in his country: he moved from the fight against capitalism and imperialism to the battle for development and modernisation. His famous remark, 'what difference does it make what colour a cat is so long as it catches mice', reflects a strategy of international insertion, far removed from ideological or religious fundamentalism. These are two opposing perspectives for diagnosing the room for manoeuvre that each country derives today from the

* This Working Paper was originally published as a chapter of our [Anuario Iberoamericano Elcano – EFE 2007](#).

** Head of International Studies at the Universidad de Tres de Febrero.

increasingly multipolar international system and, therefore, of the competition for power and the world's markets.

But to a large extent these features also reflect realities that are very much intrinsic to today's Latin America.

Without trying to provide an exhaustive list we can note the following factors, while allowing for the fact that sometimes they might manifest themselves in different ways as they are viewed in the perspective of each country:

- The presence of opposing visions on the Latin American countries' insertion in the world, both among the various countries and on their own internal fronts, with tendencies in some cases towards an approach closer to that of Deng Xiao Ping and in others marked more by elements characteristic of ideological fundamentalism –be they of the left or right– to take on categories also subject to revisionism with regard to their capacity to help understand the realities of the different countries of Latin America.
- A combination of ideological affinities among various governments and at the same time, conceptual differences over the meaning of the strategic idea of integration and perhaps over the construction of democracy, the overcoming of all forms of social fracture and insertion in the world.
- A differentiated perception of the concrete opportunities and challenges that the new international reality presents for each country, as well as acknowledgement that they are not necessarily similar in all cases and that there is not always the same capacity or margin of action for taking advantage of them.
- The renewed regional protagonism of Venezuela, including its recent incorporation into Mercosur.
- Dissatisfaction, sometimes acute, with accumulated experiences in some processes of integration.
- The growing role that energy has in the respective agendas of relevant economic issues.
- The presence of old (carry-overs from the War of the Pacific in the 19th century) and new situations of bilateral conflict (differences between Argentina and Uruguay on possible pollution from industrial projects along the banks of a river they share, or, with another scope and intensity in its manifestations, between Paraguay and Brazil over financial issues involving the mixed-capital company Itaipú).

All of this is giving a new relevance to the classic integration-fragmentation tension between countries that share an international subsystem based on geographical continuity. Even an incipient arms race could be viewed as the reflection of a return to the opposite of what the strategic idea of regional integration actually means. Building a region that is open to the world, one in which centripetal forces win out over centrifugal ones and in which there is room for many kinds of diversity, is perhaps in Latin America –and other regions of the world– a great challenge that will require a strong strategic vision and political leadership.

But it will also require a prominent role for civil society and much creativity in the area of methodology and integration techniques. At the same time it will call for prudence and political vision from the main external players with current or potential interests in the region, especially the

US, the EU and some of its member states, and also China. This paper only seeks to make a few observations to help understand what is happening with Latin American integration and its prospects for the future, keeping in mind the new realities of global politics and economics.

The Varied Mosaic of Latin American Integration

In Latin America today there is no formal process of deep integration that encompasses or seeks to encompass all the countries of this geographical region. For the purposes of our analysis, by deep integration we mean that which is reflected in the development of a regional public asset, made up of joint institutions and policies among a group of countries. In a given geographical space, this allows for creation of common rules, social networks and symbols that citizens identify with the shared region. The effect of all this is to link in a potentially permanent way a group of sovereign nations and neighbours without necessarily reaching a new autonomous entity of power within the international system.

At least for the foreseeable future, it does not seem likely that such a process of integration will develop in all of Latin America, at least with an intensity similar to that of European integration. To the contrary, what is more likely is a hardening of the current framework of fragmentation and differentiation among existing, differing processes of integration. This could even turn out to be positive, keeping in mind the many options open on the global stage and each country's possibilities for developing multi-polar strategies for international insertion.

Compared with the more homogeneous framework of integration in Europe, especially in the wake of successive enlargements of the European Union, the Latin American model is a varied mosaic. To some extent the Asian model of integration¹ might be more useful than the European one for orienting reading of and any prospective analysis of what is happening or might happen in the field of Latin American integration.

One of the institutions that takes in part of the Latin American geographical space is the so-called Rio Group. Its last meeting was held March 2-3 of 2007 in Turkmen, Guyana. It is a forum for dialogue and political agreement. But its goals do not necessarily include a process of deep integration. The Latin American Integration Association (ALADI in Spanish)² is perhaps the institution that comes closest to a broad approach calling for a process of commercial integration. It is the successor of the Latin American Free Trade Association (ALALC), created in 1960 through the Treaty of Montevideo and replaced in 1980 by another Treaty of Montevideo, which created ALADI.

Although ALADI is now composed of 12 countries, of which 10 are South American (the other two are Mexico and Cuba), not only does it not include countries participating in integration processes in Central America and the Caribbean, but in practice its specific commitments deal mainly with developing trade, especially preferential trade, among its member states. However, if it eventually managed to achieve its current goal of creating a free trade area, ALADI could boost its potential for contributing to trade and economic integration throughout Latin America and the Caribbean.

Most countries of Latin America and the Caribbean participate as full members of four sub-regional integration processes. In order of their founding, they are the Central American Integration System (SICA),³ the Caribbean Community (CARICOM),⁴ the CAN⁵ and Mercosur.⁶ Of the Latin

¹ Piero Penetta (2003), *Il Regionalismo Multipolare Asiatico: Contributo al Diritto della Cooperazione Istituzionalizzata fra Stati*, Torino.

² For information on ALADI, including a programme of activities for 2007, is available at www.aladi.org.

³ Information on Central American integration at www.sgica.org and www.sieca.org.gt.

⁴ Information at www.caricom.org.

⁵ Information at www.comunidadandina.org.

American countries with greatest relative economic weight, there are two which stand out by not belonging to any sub-regional plan, at least as full-blown members: Mexico and Chile.

Mexico⁷ is a signatory of the North American Free Trade Agreement (ALENA in Spanish and NAFTA in English).⁸ From a geographical standpoint, as well as in terms of trade and investment, Mexico is a key part of North America. This is no impediment to its multipolar insertion in the global economy –with its own network of free trade agreements, with parties including the EU and in the Latin American region– with its role as a founding member of ALADI and growing flows of trade and in particular investment, even with preferential agreements, with the countries of Central America, the Caribbean and in particular South America.

Chile,⁹ meanwhile, has stressed developing a model for multipolar insertion in the global economy. This is reflected in a wide range of free trade agreements, the most recent of which it signed with China. Highlights of these accords are the ones Chile has signed with the US and the EU. Unlike Mexico, its foreign trade and flows of direct foreign investment are more diversified in different regions of the world. With its geography and history, Chile is essentially a South American country. It is in this geographic region where it has significant political and economic interests. It has been and is destined to continue being a key player in defining the tension between the ideologies of integration and fragmentation that are typical of any international sub-system and increasingly evident in South America.

In recent years, processes of South American integration have been channelled through three main international institutions. They are Mercosur, CAN and more recently the South American Community of Nations (In Spanish, CSN or CASA).¹⁰

As we shall see, the first two are right in the middle of a process of metamorphosis and the third has not yet defined itself. In reality, it is only natural for any process of deep integration to be in a constant process of change. These are not linear trajectories. To the contrary, European integration has proven that these processes stagnate, sometimes suffer setbacks and also take periodic steps forward. It seems the point of no return is always avoided.

Meanwhile there are also links that connect these three institutions. From these there might emerge some day a fledgling institutional network of South American integration.¹¹ A first connecting link stems from an economic complementation accord signed in 2005 by the countries of the CSN and those of Mercosur, within the institutional framework of ALADI. The second is the Initiative for Integration of South American Regional Infrastructure (IIRSA in Spanish), conceived as ‘a forum for dialogue among authorities responsible for the infrastructure of transportation, energy and telecommunications of the 12 South American countries’. The third is one that the CSN hopes to develop. It is an initiative that goes back to the South American summit held in Brasilia in 2000. This meeting produced an Action Plan for Physical South American Integration. Technical and financial support were requested from the InterAmerican Development Bank, the Andean Development Corporation (CAF in Spanish), and the Financial Fund for the Development of the River Plate Basin (FONPLATA in Spanish). It is the origin of the aforementioned IIRSA.

⁶ Information at www.mercosur.int. Various analyses of Mercosur at www.redmercosur.org.uy; www.sice.oas.org, and www.felixpena.com.ar.

⁷ Information on Mexico's strategy towards external insertion and its international trade negotiations at www.economia.gob.mx/index.jsp?P=863.

⁸ Among other sources on ALENA-NAFTA, the web page of Mexico's Economic Secretariat: www.nafta-mexico.org

⁹ Information on Chile's strategy towards external insertion and its international trade negotiations at www.direcon.cl.

¹⁰ Information on the CSN, its antecedents and recent summits at www.cumbresudamericana.bo/armado.htm and also www.wikipedia.org.

¹¹ In 2006 the Secretariats of ALADI, CAN and Mercosur carried out intense work on identifying the various points of convergence among the different agreements and tools of trade integration, www.aladi.org.

La CSN was institutionalised at the political level in the Cuzco Summit in 2005. It has not yet been formalised in an international treaty. The last South American summit was held in Cochabamba in November 2006. From it there emerged a work agenda, a principle of institutionalization and the political decision to prepare a constituent accord that would formalize its existence, goals and areas of jurisdiction. For the time being it has technical support from the old Palacio Itamaraty in Rio de Janeiro.

We believe it is not an exaggeration to say that whatever happens in the next few years in the area of deep integration in South America –especially if it is conceived with criteria that favour the diversity of external options that each country has and the flexibility of operational instruments– will determine to a large extent the achievement or not of the broad goals of regional integration that the countries of Latin America have sought for at least five decades.¹² For this reason we have chosen this forum for concentrating on analysis on this issue.

We will focus our analysis of what is happening and what might be expected to happen in the future with Mercosur. We choose Mercosur because of the importance of its relative economic dimension and power –determined to a large extent by the presence of Brazil but also Argentina– and because of the fact that at its inception MERCOSUR was perceived as the nucleus of South American integration. It might still fulfil that role.

Chile's special relationship with Mercosur, Venezuela's recent incorporation into the organisation, the probability that Bolivia will follow suit and the possibility that Ecuador will do so turn this integration process into a key piece of the increasingly complex South American jigsaw puzzle.

We will now examine factors that influenced the construction of Mercosur and the processes of change currently observed within it; then we will look at its insertion into the broader South American scheme and its prospects for the future. Finally, we will draw some conclusions.

Rather than carry out a detailed analysis of the status of each of the integration aspects we will explore, our idea is to provide some elements that allow one to decode processes that tend to be hard to difficult to understand, drawing particularly on the experience accumulated with European integration.

Mercosur's Erratic Trajectory: Some Features for Understanding its Current Problems

Mercosur was conceived as a voluntary association of sovereign, neighbouring states. Its goal is to achieve a process of integration that aims to be permanent. It is an alliance with projection over the long term. Over time it can only be sustained if members perceive more benefits in remaining than in withdrawing from the organisation. Just as no one forced them to join up, no one can force them to keep being a member if they reach the conclusion that this is what best serves their national interests. That is to say, if they feel they have realistic alternatives to continued membership. And these differ depending on the member country under consideration. To sum things up, it is a process based on all the members perceiving there is a dynamic framework of mutual gains and opportunity costs compared to other alternatives.

Mercosur was created in the context of a world just beginning the post-Cold War era and a hemispheric scenario marked by then-President George Bush's launching in June 1990 of the so-called Initiative for the Americas. This gave rise at the Summit of the Americas in Miami in 1994 to the start of negotiations for establishing the Free Trade Area of the Americas (ALCA in Spanish),

¹² Félix Peña, *Moments and Perspectives: Argentina in the World and Latin America*, Buenos Aires 2003. Includes precedents and bibliographical sources on different stages of Latin American integration.

which entered into decline after the Mar del Plata summit in 2005 en Mar del Plata.

Although the concrete commitments undertaken at Mercosur's founding were mainly economic – we could even say commercial– from the outset the organisation has had a strong political component. This referred to the consolidation of democracy, an increase in each country's capacity to attract productive investments –in function of the expanded market but also as a springboard for operating in other countries, especially in the South American region– and the idea of jointly negotiating trade advantages with third countries, especially the US and the EU. It is worth recalling that the decision to form Mercosur was adopted by Argentina and Brazil at a bilateral, presidential summit in July 1990, just weeks after Bush unveiled his own initiative.

Even though Uruguay and Paraguay later joined up –Chile was invited to do so but preferred not to participate as a full-fledged member– the idea of creating MERCOSUR was an initiative of Argentina and Brazil, as a follow-up to the process of bilateral integration they started in 1986. In 1988 they even signed a bilateral treaty, which remains in force. And today it is in the bilateral realm where some of the most important economic activities are channelled, such as the automobile industry.

From the outset the process was imagined as one of gradual development, in which each step should pave the way for and determine the ones to follow. For this reason the Treaty of Asunción was so schematic –24 articles and three annexes–. More than prudence, this reflected the internal, political and economic uncertainties that existed in the main members. At the beginning of the last decade, these countries had not finished digesting years of military government or even the severe macro-economic problems of the previous decade. It also reflected the countries' lack of experience with automatic mechanisms of trade deregulation (the idea of zero duties across the range of products that had carried tariffs) and then with a common external tariff. These two were the main operational tools to which the countries committed when they founded Mercosur.

The first phase of building Mercosur was the so-called period of transition, which culminated in December 1994 in the summit of Ouro Preto. The second phase was the installation of the customs union, with the implementation of a common external tariff. This phase has not been totally completed. At the same time a phase of deep integration was supposed to have begun, focusing on two principles: macroeconomic coordination and joint productive transformation. Besides a lot of announcements and some measures designed to take Mercosur into this much more complex phase, very little progress has been made so far in this area.

Three features have marked the evolution of Mercosur from its inception. They are still present and to some extent help explain the difficulties that have emerged, especially in recent years, in the construction of Mercosur and the addressing of the phase of deep integration. These features are the asymmetry of the members, the relatively low level of interdependence among them and their reluctance to accept collective discipline, especially on the part of countries with larger economies. As for the asymmetries, the main ones are the relative economic dimensions and power, and the different degrees of development. On this level the differences among the members are acute, with Brazil at one extreme and Paraguay and Uruguay at the other. There are also differences in the degrees of relevance –and therefore of necessity– that the respective markets have for each of the members, and their options through their respective insertion in global markets. The very perception of Mercosur, its *raison d'être* and the way of building it depend on the relative dimension of each country. Another thing that varies is the density of created interests, as seen in particular in the area of productive integration.

Although this is a factor observed in other regions with different kinds of integration processes – like those in North America or Europe– something that sets Mercosur apart is that no country, not even Brazil, is in a position to play the role of engine leading the development of the rest, much less

financial partner. Nor has there been observed in the case of Mercosur the presence of a major power bent on stimulating the process of integration for reasons linked to their security agenda, such as the role played by the US at the start of European integration. The ambivalence of the US with regard to the strategic idea of Mercosur and the difficulties that have prevented formalizing the strategic alliance with the European Union reflect the absence of an external energising force for the region.

The question of asymmetries has become a central issue on the current agenda of Mercosur.¹³ This is because Paraguay and Uruguay, the two countries with the weakest economies –and lowest level of development in the case of Paraguay–, feel that such as it is, Mercosur does not suit them. Although this is a problem that stems from economic data, it has become one of the main political problems for Mercosur.

The low grade of interdependence among the members –the second of the three features that have marked Mercosur– manifests itself in particular in trade and investment flows. They continue to be relatively insignificant compared with those that link each country with the rest of the world. Brazil is a case in point. In 1990, its exports to the other three members of Mercosur totalled just a little over 4 % of its total exports. By 1998 this figure has risen to 17 %. After the crisis of 1999-2002, in 2006 the export figure was a little over 10%. In the case of the other members, in 2006 the proportion of their exports to Mercosur compared to the total were 20% for Argentina, 45% for Paraguay and 23% for Uruguay. In the area of direct investments, in the past few years an increase has been observed in those coming from Brazil, but these investments are still less than those made by countries of the OECD.

The importance that Mercosur holds for the four founding members grows when viewed from a political perspective –we note their living in a contiguous context–; the effects of showing that the respective internal political processes have for the other members, and relevance in foreign policies in the face of the US and other countries, among other factors. It is also seen in macroeconomic policies –sensitivity to phenomena such as those triggered by recessions or currency crises; in trade in industrial products and in capacity to attract productive investments, especially those stemming from large multinational networks of production of goods and rendering of services. But even in such cases one observes differential effects stemming from the asymmetries mentioned before. For instance, the dominant perception in Paraguay and Uruguay is that in some of those areas –mainly in trade in manufactured products and capacity for luring direct investments from abroad– Mercosur has essentially benefited Brazil, but also Argentina.

The third feature –members' reluctance to accept collective discipline– leads to a tendency toward scarce compliance with common rules that have been agreed and to preserve as much as possible a wide margin for unilateral action. This is seen most with Argentina and Brazil, but examples also abound in Uruguay and Paraguay.

This trend can be attributed to multiple factors. Some are cultural, such as a deficient tradition of playing by the rules in the countries themselves; this lack of respect for rules is not something characteristic of Argentina only. There is also a preference for precarious rules of play in regional integration links, something that was observed in the period of the ALALC and even that of the ALADI. Another factor is resistance, especially by Argentina and Brazil, to transferring effective jurisdiction to common bodies that lack integration and firm inter-governmental control.

Other factors reflect effects of the integration methodologies that have been used. Two aspects in particular are worth pointing out. In the first place, the processes of establishing rules have centred

¹³ On the issue of asymmetries and other relevant themes on the agenda of Mercosur from the second half of 2005 and first half of 2006, see *Informe Mercosur*, nr 11, published by INTAL-BID, January 2007, at www.iadb.org/intal.

on participation by foreign affairs ministries, and only in an erratic and marginal way has weight been given to finance ministries or their equivalents. This has yielded rules of play with low potential for being effective –having capacity to penetrate into every day life– and also for being efficient –having capacity for producing the results that were expected–. For a long time the rules agreed did not fully take effect –they have not been incorporated into countries’ domestic legislation–. And there has been a tendency toward predominance of ‘diplomacy through the media’ and ‘special effects’, especially in the periodic presidential summits. In second place we note a very low transparency in this process of establishing rules and the very rules that result from these processes. It is interesting to compare the official web page of Mercosur with that of other, similar processes, especially that of the EU, but also within the region, such as the web site of the CAN.

This insufficient transparency might be a factor that explains the scant participation of civil society in the process of integration. This weak transparency and citizen participation –and by organized social interests– can be observed in the multinational standing of Mercosur institutions but it also manifests itself domestically in each member country, even though within this level there exist acute differences among said countries.

Mercosur’s Metamorphosis: Will it be Able to Adapt to New Global and Regional Realities?

Sixteen years after its creation, Mercosur boasts a mixed record of successes and shortcomings as far as its achievements are concerned.

On the one hand, some of its achievements include the following:

- It is a relevant part of the policies of external insertion of the respective countries. Governments maintain political will to keep building it. This is still seen in cases such as those of Paraguay and Uruguay, which recently have adopted a critical attitude with regard to its results. The dominant feeling seems to be that there are no reasonable alternatives to the current process of integration.
- Its geographic expanse has spread through a network of preferential accords reached with other countries of the ALADI, many of which have the status of associate members. In 2006 Venezuela became a full member following its withdrawal from the CAN, although the formalisation of its joining has not been completed. Brazil and Paraguay –pending approval by their legislatures– still need to pass the membership protocol signed in Caracas. At the last half-year summit held in Rio de Janeiro in January 2007, it was agreed to open a process aimed at incorporating Bolivia as a full member of Mercosur.
- A significant part of trade within Mercosur is free of import duties, but this feat is undermined if one takes into account non-tariff restrictions and other trade barriers that remain in force. Nor has the bloc managed to articulate a system of escape valves for situations of economic emergency or sector-specific difficulties.¹⁴
- The common external tariff exists and is applied. But there are still exceptions to this, both legal and de facto.
- Direct investment among the member countries –including in many cases Chile– has grown in recent years, as have those stemming from multinational networks of production of goods and services, many depending on the integrated market, as is the case of the automobile sector. A significant part of those investments have gone to Brazil, taking advantage of the greater size of

¹⁴ Only one mechanism of competitive adaptation has been established at the bilateral level between Argentina and Brazil.

the domestic market and the security of having access to the markets of other member countries, in particular Argentina,¹⁵ or they have originated in companies from Brazil and Chile.

- Transport channels –especially by land– and the physical distribution of goods have developed, improving connections between urban markets. This is especially the case in the string of large cities stretching from Belo Horizonte, to Sao Paulo and Rio de Janeiro in the north, and Asunción-Montevideo-Buenos Aires-Rosario-Córdoba-Mendoza-Santiago de Chile and Valparaíso in the south. These large cities hold the largest capacity for consumption, production of industrial goods and rendering of services in all Mercosur.
- There is an institutional structure which, besides the intergovernmental bodies that date from the founding of Mercosur and have given rise to a dense network of technical agencies –recent additions include the Mercosur Parliament and the Commission of Permanent Representatives, with its presidency– includes a fledgling Secretariat and an arbitration mechanism, which has improved somewhat after the approval of the Olivos Protocol.
- Mercosur has developed a strong fabric of social networks that are active in areas including trade unions, culture and education.

On the other hand there are significant shortcomings in the construction of Mercosur. Some of the main ones are seen in these areas:

- The identity of the integration process. This has to do with the definition of why and for what the member countries have decided to work together. Sometimes it is hard to answer the question of what exactly Mercosur is. Said another way, the answers can vary depending on each national perspective, and even within political and social sectors of each country. The range of answers depends on the emphasis that is placed on political goals and content on one hand and on economic and trade-related ones on the other. The incorporation of Venezuela seems to have deepened dissonance in both realms. Caracas tends to see Mercosur as a mainly political project associated with the idea of a Bolivarian Fatherland. This does not always sit well with public opinion in other countries, especially that of Brazil, which for historical reasons is more distant from the Bolivarian tradition. Venezuela also sees Mercosur as a tool for opposing what it sees as U.S. hegemonic aims. In the original member countries, although this vision is not necessarily shared, even by governments, it is still considered necessary to go beyond a conception of Mercosur that overly stresses trade issues. This conception is considered a reflection of the economic approaches that predominated in the 1990s.
- The efficiency of its institutional mechanisms. This has to do with the issue of how the members should work together. The process of elaborating regulations at Mercosur has yielded a load of rules of play, many of which lack effectiveness and therefore they lack efficiency. In particular, from the point of view of those who have to make decisions on productive investment, many rules are just not credible. Specifically, they do not allow companies to operate in the Mercosur economic space as if it were a single market. Many questions have not been resolved. They include ones that are crucial for the idea of customs union –a backbone in the creation of Mercosur in the commitments that countries have been making, such as the Common Customs Code–. Other measures that were formally adopted never came into effect, such as the rules for defending competition, or rules for government policy that affect economic competition within the integrated economic space, including tax incentives for trade and investment. Furthermore, there has been no advancement in macroeconomic coordination. Nor

¹⁵ The fact that the Constitution of Argentina stipulates that international treaties take precedent over domestic legislation causes a legal rigidity that is seen with the same scope in Brazil. This is one of the most significant asymmetries within Mercosur.

has there been significant progress in productive integration. These two failures have aggravated the feeling that there is a lack of efficiency in the mechanisms for harmonising national interests and elaboration of regulations in the Mercosur sphere.

- Its relevance and how attractive it is for each member country. One observes the paradox that, on one hand, membership has grown while on the other there is a growing problem of social legitimacy. This is reflected in the business sectors of some countries –Brazil is one of the most prominent cases– and also those with less relative economic weight, such as Paraguay and Uruguay. One hears and reads the expression ‘such as it is, it does not work for us’, in the four founding members. But this has also been observed in Venezuelan business sectors, which have not hid their dissatisfaction over not being consulted over the decisions to quit the Community of Andean Nations or join Mercosur as a fully-fledged member.

This panorama of mixed results is reflected in an intense debate over Mercosur in the member countries, and is expressed often in the news media. The result of this is that citizens, investors and third countries are more and more perplexed over Mercosur and its future.

It can be argued that Mercosur is the middle of a process of change. The combination of factors that affect the opinions of the member countries allow one to anticipate a metamorphosis of the original project rather than a formal failure of the process of integration. However, the Venezuelan President Hugo Chavez has been more vehement in his repeated public statements to the effect that if Mercosur does not undergo a deep transformation or it will fail in the same way he considers the CAN to have failed. His proposals for reforms are not known, at least not publicly, nor how he plans to achieve the necessary consensus among all the members.

In fact, this metamorphosis has already begun. Its origin may have been the crisis unleashed by the devaluation of the Brazilian Real currency in 1999 and then the economic collapse of Argentina in 2001. The transformation centres on major questions that are now high on the agenda of Mercosur.

While there are others, the main ones seem to be:

- Addressing asymmetries among members, especially those that affect Paraguay and Uruguay, including development of the Structural Convergence Fund (FOCEM in Spanish), the first pilot projects of which were approved at the Mercosur Council meeting in Rio de Janeiro in January 2007.
- Developing the idea of a customs union and joint productive transformation.
- Strengthening Mercosur institutions.
- Joint, external trade negotiations by the bloc and eventually by each one of its members.¹⁶

In order to understand better some of the factors influencing the metamorphosis of Mercosur and evaluate its prospects, it is convenient to consider this process within the dynamics of change that are being observed in South America.

Mercosur’s Place in the Dynamics of Change in South America and its Future Prospects

The links between the space that Mercosur encompasses and the South American regional sphere

¹⁶ An issue that will be a priority in Mercosur is consensus among member countries on whatever commitments are made at the Doha round of talks at the World Trade Organisation, taking into account the existence of the common external tariff.

vary depending on the geographic perspective from which the links are observed.

When it was founded, Mercosur was perceived as a project addressing what was traditionally known as the Southern Cone –the original name of the project was the Common Market of the Southern Cone, from which Mercosur is taken–.

That perception was even present in the initial stages of the ALALC before the initiative launched by Argentina, Brazil, Uruguay and Chile spread to the Andean countries and also to Mexico. Even many earlier proposals for regional integration referred to the countries of the Southern Cone.

The Andean Group emerged in the 1960s –at first through an initiative of presidents Frei of Chile and Lleras Restrepo of Colombia–, as a reaction by some Andean countries to what they saw as excessive influence by Argentina and Brazil in the affairs of the ALALC. Meanwhile, Argentina came to foresee itself linking up with the Andean Group and in particular with Venezuela as a way to counter the growing influence of Brazil in regional affairs. This was most clear during the last Perón presidency in the 1970s. It was then that, through an initiative by Venezuela and Mexico, the Latin American Economic System (SELA)¹⁷ was created. This forum gradually lost the relevance it had at the outset.

Ever since Mercosur was created, Brazil felt strongly that the project could not be construed –even for domestic reasons– as being linked solely to the Southern Cone. For this reason in the final stages of the negotiation of the Treaty of Asunción, the word ‘cone’ was deleted and the official name ended up as Common Market of the South.

It is only natural for Brazil to push for integration throughout South America. Its geographic insertion explains this. So it comes as no surprise that the initiative that began at the Brasilia summit of 2000, the path that has led to the idea of the CSN, had strong support from Brazil. Another precedent was the Treaty for Amazon Cooperation.

This trend toward addressing South American –as opposed to Latin American– integration has grown in recent years as a result of two factors.

In the first place, from Brazil’s natural perspective, the axes of physical integration have both a southward projection, in the area of the River Plate basin, and an Atlantic-Pacific projection through inter-oceanic link-up projects, especially through Bolivia and Peru.

Secondly, access to sources of hydrocarbons has grown in importance in several countries of South America, especially energy from Bolivia and Venezuela.

If we add to this geopolitical factors, especially those linked to the region’s political stability and even to the security agendas of the various countries, and the importance of preserving preferential access to the markets of the Andean countries, it is easy to understand how the Mercosur and CAN spheres have gradually been integrated into the perspective of regional policies, not just those of Brazil, but also Argentina, Chile and the Andean countries, including Venezuela.

For this reason, even since Mercosur was created, its links with what was to be the CAN as of 1997 have had a special priority. This has been reflected in the status of associate Mercosur members that the Andean countries gradually acquired, and then the aforementioned economic complementation accord reached in 2005 within the framework of ALADI.

One factor that is speeding up the processes of change within Mercosur and CAN has to do with

¹⁷ For information on SELA and its activities, see the official Web page: www.sela.org.

various countries' interest in reaching free trade accords with the US. After those achieved by Mexico and Chile, and the countries of Central America and the Dominican Republic (CAFTA-RD), Colombia and Peru concluded their negotiations with Washington. These last two accords still need approval from the US Congress. Within Mercosur Uruguay has said that within the issue of asymmetries it needs authorisation to carry out negotiations for preferential trade terms with third countries, including the US. In December 2006 Uruguay and the US signed a framework agreement on trade and investment (TIFA) that includes the prospect of reaching a free trade accord. The accord established a consultation mechanism very similar to the one the four original Mercosur countries reached with the US in 1991, known as '4+1'.¹⁸ The current rules of Mercosur stipulate that trade accords that include tariff advantages with third countries must be negotiated jointly among all the member countries. Both Brazil and Argentina say that a free trade accord between Uruguay and the US would be incompatible with Mercosur's customs union and common external tariff.

The fact that relevant questions on the political, economic and national security agendas of the countries of the region can only be addressed at the entire South American level helps explain the momentum that the idea of the CSN has taken on.

However, it remains unclear how the three main regional integration institutions of South America will work together in the future.

Several scenarios are possible. Some of them are:

- Co-existence of the current institutions (CSN, Mercosur, CAN) with links among them, especially through the network of preferential trade agreements under ALADI. But there would be greater flexibility in Mercosur's rules –those of the CAN have already been made more flexible– with regard to the possibility of member states reaching preferential trade accords with non-Latin American countries, be this in a bilateral way or as the result of framework accords that call for common rules and regulations, although with differentiated preferential treatments. To some extent, one can view as precedents for this the agreement between Mercosur and Mexico, and the aforementioned economic complementation agreement between Mercosur and CAN.
- Evolution of CSN into a common institutional framework for South America that absorbs both Mercosur and the CAN, and also constitutes an entity for driving physical and energy-related integration, among other issues of common interest.
- Consolidation of Mercosur as the core of South American integration through the incorporation of other countries of the CAN as full-fledged members and an easing of differences that exist between full and associate members. This would involve deepening reforms of Mercosur's current mechanisms and rules –especially with regard to the customs union– in order to make them more flexible and adapted to an architecture of integration that has variable geometry and multiple speeds.

It is hard to say which of the three scenarios will prevail. It is most likely that for now, all three options –or others that are conceivable or hard to imagine now– will remain open. In any case, it seems reasonable to expect that in the next few years one will observe a trend toward South America differentiating itself from the rest of Latin America –due to a large extent by the issue of geography– and toward a multiplicity of institutions through which integration efforts are

¹⁸ Signed in June 1991 in Washington. It is also known as the Rose Garden Agreement. It remains in force, but its Council has not convened since 2002. Now that Venezuela has joined Mercosur, it does not seem likely that this forum for consultation will be reactivated for now.

channelled.

Conclusions

The following are some tentative conclusions to be drawn from our analysis:

- For the foreseeable future, Latin American integration will continue to be influenced by the processes of deep transformation observed in the international system and by growing uncertainty on the world stage.
- It is possible that a trend toward what is known as open regionalism will intensify. In this kind of regionalism, countries seek to reach alliances at the regional and sub-regional level, while pursuing strategies of multipolar insertion in the global economy, taking maximum advantage of the World Trade Organisation and the possibility of using that forum to reach preferential trade agreements.
- This will accentuate the search for links to connect institutions working toward regional integration, especially in South America, through heterodox methodologies of variable geometry and multiple speeds.
- In the near future, the multiplicity of regional integration institutions will continue to be a part of both the Latin American situation (in which ALADI could play an important role, especially but not exclusively in the area of preferential trade) and the South American one (in which the CSN, depending on the final format it takes on, could play a relevant role).
- In South America, sub-region institutions (CAN and Mercosur) will continue to be important but probably just to the extent that they enhance their ongoing processes of adapting to regional and global realities. Otherwise, their drift toward irrelevance could be irreversible. This would involve achieving an adequate combination of making their tools and rules more flexible and above all acceptance by all members of a minimum of collective discipline that they are all actually prepared to respect.
- Energy and integration of physical infrastructure will continue to be an important part of integration strategies.
- It will be difficult for South America to make substantial progress toward deep integration, at least along the lines of the model developed with European integration. It is worth keeping in mind that in the future the European Union will probably enhance its evolution toward a structure of variable geometry and multiple speeds in order to deal with the diversity it has acquired with its continuing enlargement.
- On the other hand, it is probable that influence from the Asian model of multipolar regional integration will increase. It is one open to insertion in all areas of the global economy.

South America's capacity for creating a mentality dominated by the logic of integration will depend on its ability to neutralise many factors of fragmentation that have begun to emerge in the region in recent years.

To a large extent, whether or not this happens will depend on the strengthening of a core of countries with democratic regimes and national strategies that seek to harvest all the

opportunities provided by globalisation of the international system and international economic competition.

- It will also depend on the prudence and strategic vision that South America shows in its relations with Latin America and the countries of South America itself, and with major powers with significant interests in the region –currently or potentially– in particular the US, the countries of the EU and China.

Félix Peña

Head of International Studies at the Universidad de Tres de Febrero